RAILWAY CONSOLIDATION ON THE INDIANA-ILLINOIS LINE.

IN 1895 the Supreme Court of Illinois decided that in the absence of authority granted by special charter before the present Constitution, railway corporations of Illinois had no authority to consolidate with corporations of other States, and that for this reason where a combination formed by a railway company organized under the general laws of Illinois and corporations of other States had given a mortgage upon their entire property, the mortgage constituted no lien whatever upon the property in Illinois, and that the bonds were to this extent without security.[1]

This decision surprised many of the Illinois bar and many holders of railway securities. All roads of importance operating within the State extend beyond its limits, and changes of corporate organization are continually necessary. Prior to 1874 railways were authorized by statute to consolidate with companies whether organized in Illinois or elsewhere, but in that year this statute was repealed, and the legislature appeared to declare a policy adverse to such consolidations. In subsequent legislation this policy has been emphasized, as in the Act of May 24, 1877, which expressly provides that nothing therein contained shall authorize consolidation of railway corporations of Illinois with those of other States,[2] and in the proviso of the Act of March 30, 1875,[3] that nothing therein should be construed to authorize foreign railways to become the owners of any railroad in Illinois.[4] By the Act of June 14, 1883, an exception was made to the general rule forbidding consolidation with railway companies of other States, so far as to provide that whenever a railroad situated partly in Illinois and partly in another State and theretofore owned by a consolidated corporation had been sold under decree of court and purchased as an entirety in the name of corporations organized under the laws of different States, these corporations might consolidate. With this exception, however, the

[1] American Loan & Trust Co. *v.* Minnesota & Northwestern R. R. Co., 157 Ill. 641.
[2] Starr & Curtiss, Stats. of Ill., 2d ed., iii, 3248.
[3] Starr & Curtiss, Stats. of Ill., 2d ed., iii, 3240.
[4] Starr & Curtiss, Stats. of Ill., 1st ed., ii, 1917.

legislative policy of Illinois continues adverse to such consolidations.

Since the repeal of the statute in 1874 a number of roads operating across adjoining States have refused to consolidate with corporations of Illinois, but have made their terminus at the Illinois State line, and have reached points within the State by means of leases, operating contracts, or stock ownership.

Most railways have, however, refused to follow so conservative a course, and many so-called consolidations have been made as though the act authorizing consolidation were still in existence. Securities have been issued by these consolidated companies for many millions of dollars, and the rule announced in the American Trust Company case throws great doubt upon the validity of all these transactions. The result has been the passage, in 1897, of a statute ratifying consolidations made by corporations of Illinois and those of other States between July 1, 1874, and July 1, 1883.[1]

There may be some doubt whether this statute can have the intended effect, but in any event it gives no authority for the many consolidations which have been made during the last fifteen years. Among the interests thus threatened are some very valuable securities, and the questions presented are, by reason of their magnitude, of national importance.

Beside these two methods of dealing with the law, — that is, of directly obeying or disobeying it, — there also developed upon the Indiana-Illinois State line a third course by which some lawyers have considered that the fruits of consolidation might be obtained without the fact. This is the method now in vogue when railway corporations operating eastward from Illinois are united. Large investments have been made and are making upon faith in the validity of this scheme. It may be that this faith will be justified, but whatever the ultimate result, it seems clear that those who make these investments take a substantial present risk.

It is the policy of Illinois that railroads within the State shall be operated by domestic corporations. Until recently and with a single exception,[2] an Illinois railway could not sell its road to a foreign corporation, but, so far as the Illinois law was concerned, could purchase a railway in another State.

The statutes of Indiana provide that companies organized under

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[1] Session Laws of Illinois, 1897, 198.

[2] Act of 1895, Starr & Curtiss, Stats. of Ill., 2d ed., iii, 3240.

the laws of that or of any adjoining State whose roads connect upon the State line or elsewhere may join and unite their roads and merge and consolidate their stock upon such terms as may be mutually agreed upon in accordance with the laws of the adjoining State with whose railroads connections are thus formed.[1]

This last phrase does not adopt the law of adjoining States, but is construed as requiring that the terms of the agreement of consolidation be not in conflict with the laws of those States.[2]

The laws of Indiana, like those of Illinois, do not authorize a domestic company to sell or lease its property to a foreign corporation. The question that presents itself, therefore, is whether a purchase of an Indiana road can be effected by an Illinois corporation in such a way that it will be regarded in Illinois as a purchase and not a consolidation, and in Indiana as a consolidation and not a sale.

It is said that all the requirements of this situation are met when the two companies make an agreement, by which the Indiana road transfers all its property to the Illinois corporation and passes out of existence, while the Illinois company, in consideration for this conveyance, issues its stock directly to the Indiana stockholders. Consolidations often take the form of purchase and sale,[3] and it is not necessary that both constituent companies should continue to exist. Sometimes consolidation is made by dissolving both companies, or by dissolving either one, while preserving the other company and issuing its shares to stockholders in the dissolved company.[4]

It appears, therefore, that the use of the word "consolidation" in the Indiana statutes does not alone require that when consolidation is made, the constituent companies shall all continue their existence.

This apparently is the understanding of the courts of Indiana.

In Jessen *v.* Commissioners of Lake County,[5] the court said: "Under our statute providing for the consolidation of railroad companies, the consolidation is the result of contract between such

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[1] Act of February 23, 1853, amended March 8, 1897. Burns, Annotated Stat. of Indiana, § 5257.

[2] Bradford *v.* Railway Co., 142 Ind. 383.

[3] Thompson, Corporations, i, § 324; Lauman *v.* Lebanon Valley R. R. Co., 30 Pa. St. 46; Racine, etc. R. R. Co. *v.* Farmers' L. & T. Co., 49 Ill. 331.

[4] Morawatz, Corporations, § 942.

[5] 95 Ind. 567–577.

companies, and the question as to whether either or both of the original companies, by reason of the consolidation become extinct or cease to exist, must depend very largely, if not entirely, upon the terms of the contract of consolidation mutually agreed upon in each particular case." [1]

In Cashman *v.* Brownlee,[2] the court quoted approvingly from Rorer on Railroads [3] the statement that "the Legislature may allow a consolidation of two railroad corporations whereby the one so merged loses its corporate existence. . . . The company so merged, that is all its members, pass into and become members of the company into which it is merged."

It is at this point in the consideration of the Indiana decisions that we reach the very suggestive case of Easton & Hamilton Ry. Co. *v.* Hunt.[4] In that case, an Indiana railway corporation had sold and conveyed its property to a corporation of Ohio, taking in payment stock in the Ohio Company, which was distributed to the stockholders of the Indiana Company. It does not appear that counsel attacked this proceeding, and no doubt as to its validity is suggested in the opinion of the court.

Branch *v.* Jesup [5] resembles the Hunt case. The South Georgia and Florida Railroad had been authorized to construct a line from Oglethorpe to Albany; from Albany to Thomasville, and from Thomasville to the Florida line. Its powers authorized it to purchase and sell all kinds of property, and to incorporate its stock with that of any other company.

Acting under these powers, it entered into a contract with the Albany & Gulf Railroad Company to construct a road from Thomasville to Albany, and to sell it to the Gulf Railroad Company, together with the franchise of using it, receiving pay therefor in the stock of the Gulf Road. The transaction was carried out and sustained.

The court after referring to the authority of the Georgia Company to purchase and sell property of all kinds and to consolidate its stock with the stock of other companies, goes on to say: —

"It seems to us clear that these powers were sufficient to enable the company to sell its road and franchises to any company competent to purchase them. As a general rule, it is true, a railroad company with only the ordinary power to construct and operate its road cannot dispose

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[1] See also Crawfordsville, etc. Co. *v.* Fletcher, 104 Ind. 97–106.
[2] 128 Ind. 266–269, 270.
[3] i, 38.
[4] 20 Ind. 457.
[5] 106 U. S. 468.

of it to another company. Legislative aid is necessary to that end. But this company had, by its charter, express power to incorporate its stock with the stock of any other company. This power has an enlarging effect upon the ordinary power to sell and dispose of property belonging to the company. Generally the power to sell and dispose has reference only to transactions in the ordinary course of business incident to a railroad company; and does not extend to the sale of the railroad itself, or of the franchises, connected therewith. Outlying lands, not needed for railroad uses, may be sold. Machinery and other personal property may be sold. But the road and franchises are generally inalienable; and they are so not only because they are acquired by legislative grant, or in the exercise of special authority given, for the specific purposes of the incorporating act, but because they are essential to the fulfilling of those purposes; and it would be a dereliction of the duty owed by the corporation to the State and to the public to part with them. But where, as in this case, power is given to incorporate the capital stock with the stock of any other company, a very large addition is made to the ordinary powers granted to a company. In this country, the creation and exercise of such a power is well understood. It contemplates not only the possible transfer of the railroad and its franchises to another company, but even the extinguishment of the corporation itself and its absorption into a different organization. The greater power of alienating or extinguishing all its franchises, including its own being and existence, contains the lesser power of alienating its road and the franchises incident thereto and necessary to its operation. Its power of alienation and sale extends to a class of subjects to which it does not ordinarily apply. In view of the large power thus conferred upon the South Georgia and Florida Railroad Company, we cannot doubt that it had full power to enter into the arrangement made with the Atlantic and Gulf Railroad Company for the transfer of that portion of its line extending from Albany to Thomasville, including the franchise of constructing and using the same and an incorporation of all its stock, issued for the construction of said road with the stock of the latter company."

If these were all the authorities on the subject, it would seem that the method of consolidation under consideration was authorized by law. There is, however, an embarrassing decision to be found in the case of Commissioners of Tippecanoe County *v.* Railway Co.[1] In this case the question arose as to the validity of an agreement made by an Indiana company with an Illinois company whereby the Indiana company leased its road for 999 years, giving to the lessee the option to purchase the property. It was treated, however, by the court as a sale, "different from a sale and

[1] 50 Ind. 8

delivery in nothing except that the consideration for the transfer is paid semi-annually instead of in a sum total. The true character of the instrument, therefore, if the parties choose so to treat it, is that of a sale; and it seems to us a perversion of the meaning of words, and an evasion of law, to give it any other interpretation."

In passing upon it in the character of a sale, the court says: —

"But it is urged by the appellees that there is authority of law for making the contract in question, if not in express terms, yet by fair interpretation, whether it is called a lease or a sale; and they cite the Act of February 23, 1853. That act is 'to authorize railroad companies to consolidate their stock with the stock of railroad companies in this or in an adjoining State, and to connect their roads with the roads of said companies,' etc. The title nowhere mentioned a lease or a sale. Indeed, the words 'to connect their roads with the roads of said companies' would seem to exclude such a conclusion. To connect one road with another does not fairly mean to lease it or to sell it to another."

This case appears to establish in Indiana the present rule that domestic railways may not lease or sell their roads. "We look in vain in this latest decision of the State for an assertion of the proposition that, by the laws of that State or by the decisions of its courts, there exists any law by which one railroad company can, by lease or by any other contract, make an absolute surrender of its road and its franchises to another. And yet that was the question under discussion, and because the lease in that case continued a clause of perpetual renewal, and in effect amounted to a sale, the court held it *ultra vires*."[1]

In the recent Vandalia case[2] this construction of the Indiana statute was reaffirmed. It is true that in both of the cases last referred to the question involved concerned the right of an Indiana railway to become the lessee of the property of another corporation, but in the opinion of the court the general effect of the Indiana statute was necessarily considered, and the statements quoted holding that the power granted to railroad companies by this statute to consolidate with other companies and to connect with other roads, does not carry with it the power to sell their property or franchises, are in accordance with the weight of authority upon the subject, especially in the case of interstate railways where a sale would turn

[1] Pennsylvania Co. *v.* St. Louis, etc. Co., 118 U. S. 290, 313, 630, 634.

[2] St. Louis Rd. *v.* Terre Haute Rd., 145 U. S. 393, 404-405.

the property over to a foreign corporation.[1] As emphasizing the fact that general language will not apply to an interstate railway when it will apply to a domestic road, there is an interesting decision in New Jersey which holds that a statute in general terms authorizing railroad companies to lease their properties will not authorize a domestic company to lease its property to a foreign corporation,[2] and many other decisions of this character may be found.

This review of the cases indicates that a transaction which amounted to nothing more than a sale by an Indiana road of its property to an Illinois company could not be justified under the Indiana statute. The rule is that an Indiana corporation cannot sell its road to a corporation of Illinois. Sale may be defined as the act of parting with property for a consideration, reserving to the vendor no control over the property conveyed.

Substituting this definition for the word, we have the rule that an Indiana railway company may not convey its property to an Illinois company without reserving to itself, the Indiana company, some control over the property conveyed. An Indiana corporation may, so far as concerns Indiana, consolidate with an Illinois company, but this consolidation must be of such a character that the domestic corporation will continue to exercise some control over its corporate property. In other words, consolidation which will be supported by the Indiana laws must be something more than a mere sale.

Coming now to the Illinois law, we find that a railway corporation of that State is without power to consolidate with a railway corporation of another State, but may purchase the property of a foreign company. This is precisely what Indiana does not allow, and no progress in this direction can be made under the Illinois statute. It is at this point that the difficulties are much increased by the decision of the Supreme Court of Illinois in Chicago, etc. R. R. Co. *v.* Ashling.[3] This case holds that where one corporation transfers all its property to another corporation in consideration of stock in the second corporation issued to stockholders in the first corporation, the transaction amounts to a consolidation, and is not a mere purchase and sale.

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[1] Cook, Corporations, 3d ed., ii, § 894.

[2] Black *v.* Railroad Co., 24 N. J. Eq. 456.

[3] 160 Ill. 373.

A similar decision was very recently rendered in Indiana.[1] The present tendency of the courts seems, therefore, to be toward a holding that the combination of railway companies of Illinois and Indiana made in the manner described, will not be regarded as a consolidation in Indiana, and a purchase or sale in Illinois, but that on both sides of the line the combination will be regarded as an attempt to consolidate, lawful in Indiana but unauthorized in Illinois.

It appears, therefore, that a question exists as to the validity of the consolidation of railway corporations organized under the general laws of Illinois and Indiana, and that this question extends to and affects the legality of corporate securities. It is likely that some time this question will be settled in the courts, and if so the litigation will hold out no prospect of reward for those who so easily assume its risks, and in the case of unfavorable result may entail great disaster upon bondholders.

E. Parmalee Prentice.

CHICAGO, January, 1899.

[1] Railroad Co. *v.* State, 51 N. E. Rep. 924.